In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1329

JAMES D. BALLOU AND SARAH L. BALLOU, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented by this tax case is whether petitioners' three minor children were genuine participants in a family partnership so that part of the business's income would be taxed to the children. The jury found that they were not. The court of appeals affirmed, stating that the evidence supported the conclusion that the parents' transfer to the father as trustee for the children of partial interests in the business formerly owned by the parents alone had not resulted in the creation of a bona fide partnership interest in the children, but had instead left unaffected the father's control of the venture. No question of general importance is presented, there is no conflict of decisions, and no reason for further review.

264-589—67

In 1947 petitioners (husband and wife) formed a partnership, Ballou Services, and through it provided office services to the public. They were equal partners, and each contributed capital and services to the business. (R. 9a.) [1] On December 31, 1951, petitioners transferred to each of three trusts, of which the husband was designated trustee, a 15-percent capital interest in the partnership. Each of the three minor children—the oldest was then 7 years old—was the beneficiary of one of the trusts. (R. 10a.) Thereafter petitioners individually, and the husband as trustee, executed a "partnership agreement" effective January 1, 1952. That document purported to create a new general partnership, with the same name of Ballou Services. The husband and wife each owned as individuals 27½ percent, and each of the three trusts owned 15 percent. The husband was required to devote his full time to the partnership in his individual capacity, but was prohibited from serving the partnership in his capacity as trustee. No partner could transfer or encumber his share without the consent of all. (R. 10a, 17a–20a.)

The 1954 Code recognizes a person as a member of a family partnership if he or she "owns a capital interest in a partnership in which capital is a material income-producing factor." 1954 Code § 704(e)(1). In enacting this provision Congress recognized that the courts would have to ascertain whether a person whom

[1] "R." references are to the Appendix to the petitioners' brief as appellant in the court of appeals. "Supp. R." references are to Appendix B to the government's brief in the court of appeals, printed separately.

the family had denominated a "partner" was in fact the owner of an interest in the partnership:

> [Section 704(e)(1)] leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of *Helvering* v. *Clifford* (309 U.S. 351). * * * Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny. All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale. [H. Rep. No. 586, 82d Cong., 1st Sess., p. 33; see also S. Rep. No. 781, 82d Cong., 1st Sess., pp. 39–40.]

The Commissioner of Internal Revenue determined in this case that the three trusts did not genuinely own interests in the partnership. He therefore attributed to petitioners the full amount of the partnership's 1956, 1957, and 1958 taxable income. Petitioners paid the resulting deficiency and sued for a refund in the district court. (R. 4a–5a, 6a.) On the basis of a stipulation of fact, documentary evidence, and petitioners'

testimony, a jury returned a general verdict for the United States. (Supp. R. 27b–29b).[2] The jury in addition answered in the negative the following interrogatory:

> "1. Have the plaintiffs proven by a preponderance of the evidence that each of the three trusts which they created for their children genuinely owned a fifteen percent capital interest in Ballou Services? [Supp. R. 29b.][3]

In these circumstances, "[w]here a jury has tried the matter upon correct instructions[4] the only inquiry is

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[2] There is no merit to petitioners' contention (Pet. 15), rejected below (Pet. 35–36), that the jury was required to accept the allegedly "uncontradicted testimony" of petitioners since they were the only witnesses. The jury's ultimate conclusion was based on the witnesses' description of how the trusts were established and the business conducted, as well as on other evidence. But even assuming that the testimony had been such as to allow, if credited, only a verdict for petitioners, and had been the only evidence, the jury would have been entitled to give that testimony careful scrutiny, *Glayd* v. *Commissioner*, 63 F. 2d 649 (C.A. 8), certiorari denied, 290 U.S. 633; *Chesbro* v. *Commissioner*, 225 F. 2d 674 (C.A. 2), and to weigh petitioners' testimony according to their manner and demeanor, *Stephan* v. *United States*, 133 F. 2d 87, 95 (C.A. 6).

[3] Three other interrogatories were posed, but answers were not required in the event of a negative response to the first.

[4] Petitioners' only present attack upon the instructions is an argument that the jury should not have been required to find, as a premise for ruling for petitioners, that "capital [was] a material income-producing factor" in petitioners' business. Such a finding is plainly required by the explicit language of Section 704(e)(1), although in the present case neither the jury nor the courts below were required to decide the point in view of the verdict adverse to petitioners on the question of the bona fide nature of their children's status as partners. The case upon which petitioners rely, *Commissioner* v. *Culbertson*, 337 U.S. 733, is in any event inapposite. There the question was whether sons, through the donation of services or capital, had

whether it cannot be said that reasonable men could reach differing conclusions on the issue." *Commissioner* v. *Duberstein*, 363 U.S. 278, 290–291.[5] Here the father's continued management and domination of the business, the prohibition upon a trustee providing services to the business, the inability of a trustee to remove trust assets from the partnership business, and the failure of the children or any outsider on their behalf to contribute capital to the partnership, are all factors that support the jury's decision. As petitioners state, "the fact that Mr. Ballou * * * retained 'the same control of the management of the new partnership as he had previously exercised over the old' is * * * to be expected as natural under the circumstances" (Pet. 9). Compare *Helvering* v. *Clifford*, 309 U.S. 331, 336.[6]

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intended to become their father's partner. Here the children were too young to provide services and the trustee acting on their behalf was explicitly forbidden by the partnership agreement to serve in their stead. Therefore, the only way in which they could have become partners was by ownership of a capital share in the venture, a circumstance that requires satisfaction of all the provisions of Section 704(e)(1).

[5] The court below thus applied the correct test in finding that there was evidence "to support the verdict * * *" (Pet. 29).

[6] Petitioners assert (Pet. 5), but have made no effort to demonstrate, a conflict among circuits. The only cases cited that deal with the tax consequences of family partnerships are *Pflugradt* v. *United States*, 310 F. 2d 412 (C.A. 7); *Stanback* v. *Commissioner*, 271 F. 2d 514 (C.A. 4); and *Miller* v. *Commissioner*, 203 F. 2d 350 (C.A. 6). In *Pflugradt*, the court refused to find that minor children were bona fide partners; in *Stanback* partnership interests of the taxpayer's wife and children were held by an outside trustee; and in *Miller* a grandfather donated capital to the parents' partnership with the express intention of obtaining a partnership interest for the children.

For the foregoing reasons, the petition should be denied.

Respectfully submitted.

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